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The Economic Benefits and Costs of U.S. Trade

The President's Council of Economic Advisers has recently put out a report on [The Economic Benefits of U.S. Trade](#). The Council seems to forget that trade and foreign investment flows have costs as well as benefits. It's true that the benefits often outweigh the costs, leading to the argument that winners can compensate losers. But in America, winners rarely compensate losers; more often than not, the winners attempt to trounce the losers.

There are four main kinds of costs to expanded international trade and foreign investment flows.

First, when trade changes relative prices, it also changes the U.S. distribution of income. For example, when trade with China lowers the price of labor-intensive manufactured goods exported by China, the wages of U.S. manufacturing workers (and in some cases, of all workers) tend to be hit.

Second, when trade leads to the outflow of investment from the U.S. to low-wage countries such as China, Mexico, or Vietnam, jobs are lost in the U.S. and wages are thereby subjected to downward pressure. The income distribution shifts from labor to capital.

Third, when trade leads to a race to the bottom in labor standards, environmental standards, and corporate taxation, then workers, the environment, and budget revenues all bear a burden, even as capital owners are increasing their profits.

Fourth, globalization empowers multinational companies relative to host governments. These companies have used trade and investment agreements to increase their bargaining power on issues like intellectual property and to weaken the ability of host governments to regulate internationally mobile corporations.

The Council of Economic Advisers report does not mention these four points, even though they are the standard fare of economic theory and empirical analyses. In fact, the CEA report basically treats the Trans-Pacific Partnership (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP) as examples of trade promotion, when in fact these agreements are at least as much about foreign investment flows and regulations. The mischaracterization of these treaties is especially misguided since many of the regulatory changes would give excessive power to multinational companies, for example in investor-state disputes and in intellectual property.

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The report cherry-picks the positive outcomes of trade and foreign investment flows without mentioning the downsides. And as a result, the CEA report ignores the critical challenges truly facing U.S. negotiators in achieving positive outcomes from the ongoing TPP and TTIP negotiations with Asia and Europe.

Many studies have recently demonstrated that U.S. trade with developing countries, and most importantly with China, has cost jobs and lowered wages of U.S. workers. Yes, the CEA is right to say that exports raise wages; but remarkably the CEA report ignores the role of imports in lowering wages. [A March 2015 NBER paper by Ebenstein, Harrison and McMillan](#) reaches the following conclusions:

We find significant effects of globalization, with offshoring to low wage countries and imports both associated with wage declines for U.S. workers. We present evidence that globalization has led to the reallocation of workers away from high wage manufacturing jobs into other sectors and other occupations, with large declines in wages among workers who switch, explaining the large differences between industry and occupational analyses. While other research has focused primarily on China's trade, we find that offshoring to China has also contributed to wage declines among U.S. workers.

Some have recently claimed that the U.S. has already lost all of the manufacturing jobs that it stands to lose, and can therefore only benefit regarding service jobs, a sector where U.S. workers have (it is claimed) a clear comparative advantage. Such a perspective is wildly over-optimistic on two counts. First, with 12.3 million workers in U.S. manufacturing, there are, alas, still millions of jobs that could be offshored. And regarding services, there is every reason to expect that a large swath of service sector jobs can also be offshored as happened with manufacturing jobs, especially since many U.S. service-sector activities can be offshored and then re-imported online back to the U.S.

Regarding the race to the bottom, several important studies by the OECD and others have confirmed that globalization has weakened the ability of governments to collect taxes on corporate income. Partly this is the result of a classic race to the bottom, in which each country cuts its tax rate in order to attract internationally mobile capital from other countries. Partly the revenue losses are the result of aggressive tax avoidance practices by companies that exploit gaps in the international tax system. Either way, increased trade and investment integration is undermining the tax base.

Here is how the OECD put it in its important 2013 study on [Addressing Base Erosion and Profit Shifting](#):

Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for many countries. While there are many ways in which domestic tax bases can be eroded, a significant source of base erosion is profit shifting. This report presents the studies and data available regarding the existence and magnitude of base erosion and profit shifting (BEPS), and contains an overview of global developments that have an impact on corporate tax matters and identifies the key principles that underlie the taxation of cross-border activities, as well as the BEPS opportunities these principles may create. The report concludes that current rules provide opportunities to associate more profits with legal constructs and intangible rights and obligations, and to legally shift risk intra-group, with the result of reducing the share of profits associated with substantive operations. The report recommends the development of an action plan to address BEPS issues in a comprehensive manner.

The CEA report makes a very sweeping and incorrect claim that globalization has improved the natural environment by expanding world income and thereby the national investments to combat pollution. That might be true for some kinds of relatively local pollutants such as sulphur dioxide, but there is no evidence whatsoever that globalization has worked to reduce the emissions of greenhouse gases (GHGs) associated with global climate change. In fact, the high-income countries have simply outsourced a considerable share of their overall CO₂ emissions to production abroad, notably in China. Here is how [an important 2010 study](#) put it:

We find that, in 2004, 23% of global CO₂ emissions, or 6.2 gigatonnes CO₂, were traded internationally, primarily as exports from China and other emerging markets to consumers in developed countries. In some wealthy countries, including Switzerland, Sweden, Austria, the United Kingdom, and France, >30% of consumption-based emissions were imported, with net imports to many Europeans of >4 tons CO₂ per person in 2004.

International trade and foreign investment can indeed offer many important benefits as mentioned in the CEA report: a larger market for innovation, a shift of production patterns towards comparative advantage, poverty reduction in low-income countries, and more. Yet these benefits will also come with costs, and indeed very high costs, to some parts of society, unless the U.S. and other governments take serious measures involving income redistribution and public investments in skills of the workforce and in technological advances.

New trade and investment agreements like the TPP and the TTIP must therefore be accompanied through domestic policies and within the trade agreement by strong policy measures to ensure that workers and the broad public reap the benefits of trade, instead of those benefits accruing mainly to owners of capital. These should include:

- (1) Strong obligations on labor with provision to ensure compliance and environmental standards, including the reduction of greenhouse gas emissions;
- (2) Strong protections of human rights of workers and indigenous communities, including in rural areas where extractive industries operate (e.g. mining and agricultural regions);
- (3) Global cooperation within the treaties to clamp down on tax evasion and tax avoidance through aggressive tax shifting that exploits existing loopholes in international tax law;
- (4) Meaningful opening of foreign markets including non-tariff barriers that keep U.S. products out of many of the partner countries, in line with the opening of U.S. markets;
- (5) Strong authority of host governments to regulate businesses, including foreign investors, and ensuring that dispute settlement mechanisms (such as Investor-State Dispute Settlement mechanisms) do not undermine the authority of host governments to regulate businesses;
- (6) Robust programs by the U.S. government on trade and investment adjustment assistance for workers who are hurt by offshoring and import competition; and
- (7) Robust and expanded programs on job training and higher education to prepare U.S. workers for 21st century patterns of global trade and production.